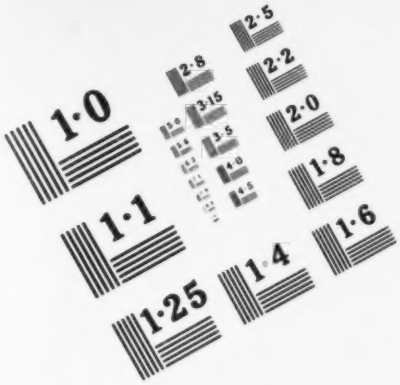

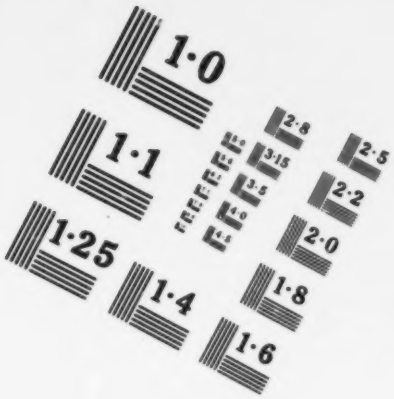

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Foreign Economic Trends and Their Implications for the United States

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MADAGASCAR

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KEY ECONOMIC INDICATORS

	1988	1989	% Change	1990 Estimates
DOMESTIC ECONOMY				
Population (1,000s)	10,903.1	11,208.4	+ 2.8	11,544.6
Population Growth (%)	3.0	2.8	- 6.6	2.8
GDP Current Prices (Mil. $)	1,814.5	2,047.5	+12.8	2,153.7
Per Capita GDP Curr. Pr. ($)	166.4	182.7	+ 9.7	186.6
GDP Current Prices (Bil. FMG)	2,721.8	3,132.7	+15.1	3,583.8
GDP Cons.(1984) Pr. (Bil. FMG)	1,465.9	1,524.7	+ 4.0	1,587.6
Cost of Living (December):				
Trad'l Sector (6/72:100)	971.1	1,074.1	+10.6	1,170.5
Modern Sector (6/72:100)	905.4	1,009.3	+11.5	1,100.2
PRODUCTION AND EMPLOYMENT				
Labor Force (1,000s)	5,140.6	5,371.9	+ 4.5	5,700.0
Indust'l Prod. Index (1982:100)	101.3	106.7	+ 5.3	110.5
Prod.: Rice, paddy (1,000 MT)	2,140	2,380	+10.7	2,400
Coffee, green (1,000 MT)	82,200	81,000	- 1.4	82,500
Vanilla (Metric Tons)	1,320	1,300	- 1.5	1,200
Sugar (Metric Tons)	114,708	120,407	+ 5.0	128,000
Chromite (Metric Tons)	107,484	165,397	+53.9	170,000
Graphite (Metric Tons)	14,151	15,865	+12.1	17,000
Textiles (1,000 Meters)	56,468	59,496	+ 5.4	63,000
Refined Petr. Pr.(Cu.M.)	376,030	210,355	-44.1	250,000
Electricity Pr. (1000 Kwh)	406,102	429,813	+ 7.5	460,000
BALANCE OF PAYMENTS				
Exports, FOB (Curr. Mil. $)	284.1	315.2	+10.9	290.0
Imports, FOB (Curr. Mil. $)	318.9	315.0	- 1.2	320.0
Trade Balance (Mil. $)	-34.8	+ 0.2	-	-30.0
Current Account Balance	-309.8	-303.4	- 2.1	-312.0
External Public Debt (Mil. $)	3,330.8	2,960.2	-11.1	3,144.6
Debt Service Ratio:				
Before Rescheduling:	103.6	105.2	+ 1.5	93.7
After Rescheduling:	56.7	71.6	+26.2	62.0
Average Exchange Rate (FMG - US$)	1,500	1,530	+ 2.0	1,520
U.S./MADAGASCAR TRADE				
U.S. Exports to M/scar, FAS (Mil. $)	12.2	7.3	-40.1	15.0
U.S. Imports from M/scar, CIF (Mil. $)	50.5	37.7	-25.3	40.0
U.S. Trade Balance (Mil. $)	-38.3	-30.4	-20.6	-25.0
U.S. Share of Malagasy Exports (%)	17.3	12.0	-30.6	13.8
U.S. Share of Malagasy Imports (%)	3.7	2.3	-37.8	4.7
U.S. Bilateral Aid (Mil. $)	29.1	19.0	-34.7	26.1
Economic	28.0	18.3	-34.7	25.0
Military	1.1	0.7	-36.3	1.1

Main U.S. Exports (1989) - (Value in Mil. $): Malt extract, flour, milk and products, 0.8; Parts of airplanes and helicopters, 0.8; Automotive vehicles, 0.5; Tractors, 0.4; Soybean oil, 0.4; Fats, 0.4; Medicinal & pharmaceutical products, 0.4; Commingled food exports, donated, 0.3; Commercial calcium hypochlorite, 0.3.

Main U.S. Imports (1989) - (Value in Mil. $): Vanilla, 24.6; Graphite, 3.7; Sugar, 2.9; Coffee, 1.5; Cloves, 0.7; Cinnamon products, 0.5; Lobsters, 0.5; Tuna, 0.4; Woven cotton fabrics, 0.3; Essential oils, 0.3.

I. SUMMARY

Madagascar is one of the poorest countries in the world. Inappropriate economic policies, declining terms of trade, and a large external debt burden have all contributed to economic decline in the 1980s. While the government has pursued an economic reform program under the auspices of the World Bank and International Monetary Fund (IMF) since 1982, significant economic growth has so far eluded Madagascar.

There are, however, some encouraging signs. Last year the growth in GDP exceeded the growth in population for the first time in a decade, suggesting the reforms may finally be having some effect. Reforms of the trade sector have enhanced the efficiency of Malagasy industry while reforms in the agricultural sector have brought prices of most crops more in line with world prices, thus encouraging production. The government is also in the process of reforming its budget, privatizing many parastatals, opening up the banking sector to private companies, and revising the foreign investment code.

The evolving economic situation is creating opportunities for U.S. businesses. The government's public spending program should increase Malagasy imports. The government also hopes to develop its largely unexploited mineral resources. There are also promising opportunities in labor-intensive industries, such as clothing manufacturing geared towards export, and in tourism-related projects. If the government follows through on its revision of the investment code, the climate for foreign investment could be significantly improved.

II. BACKGROUND

The Country

Madagascar is an island in the Southwestern Indian Ocean located 300 miles off the East African coast. Its neighbors are Mozambique and South Africa on the mainland, the Comoros Islands to the northwest, and the islands of Reunion (France) and Mauritius to the east. It is the fourth largest island in the world (225,000 square miles), larger than France and nearly the size of Texas. Its population is estimated at just over 11 million, and its population density of about 50 people per square mile is similar to that of the United States.

Madagascar's varied climate and soil conditions permit a wide variety of agriculture. Some 80 percent of the work force is involved in agriculture, which accounts for 40 percent of GDP and 80 percent of export earnings. The staple food is rice, the Malagasy being the largest per capita rice consumers in the world (about 246 pounds a year). Its major agricultural exports include coffee (traditionally accounting for about a third of export

receipts), vanilla, cloves, and sugar. Seafood exports, especially lobster and shrimp, have grown significantly in recent years.

Madagascar is also endowed with several minerals, including: chromite, graphite, mica, quartz, titanium, and precious and semiprecious stones. Coal, natural gas, tar sands, and heavy oil deposits have been discovered, but exploration has yet to reveal economically viable hydrocarbon deposits.

Lastly, the 1987 devaluation has given Madagascar one of the lowest cost labor forces in the world.

Economic Policy

Madagascar maintained free-market, outward-oriented economic policies and extremely close ties to France from independance in 1960 until the mid-1970s. During that period, Madagascar enjoyed steady economic growth.

Following the political turmoil of the mid-1970s and the resulting socialist regime, the government greatly increased its control over the private sector, nationalized many foreign companies, subsidized consumer goods, and embarked on an ambitious public investment program, largely financed by foreign loans. These policies resulted in greatly increased inflation, government deficits, and foreign debt.

The government began an economic reform program in 1980 which has been supported by the IMF and World Bank since 1982. Initial reforms focused on restraining demand. Through cuts in government spending and domestic credit, the government was able to reduce the fiscal and current account deficits and the inflation rate. However, these measures contributed to a cumulative 25 percent drop in per capita GDP from 1980 to 1988, before registering a slight increase in 1989.

In recent years economic reform efforts have focused on enhancing efficiency and stimulating growth. The government eliminated most controls on prices and profit margins for industrial goods. It revamped its trade policy, devaluing the Malagasy franc (FMG), replacing the highly discretionary foreign exchange allocation system with a market-based one, eliminating most non-tariff barriers and rationalizing the tariff structure. It also eliminated most government monopolies and restrictions on exports. It has taken the politically sensitive step of eliminating consumer price controls and subsidies on rice.

III. CURRENT ECONOMIC SITUATION AND TRENDS

Overview

The results of economic reform to date have been mixed. There

have been significant improvements in resource allocation resulting from reform, particularly the reform of the trade sector, but economic growth has been minimal. The lack of progress is due to continued deterioration in Madagascar's terms of trade, its heavy debt burden, and remaining inappropriate government policies.

There is, however, cautious optimism that economic recovery may have begun in 1989. The effects of earlier reforms appear to be taking hold and should be reinforced by additional reforms. Moreover, the government is launching a large public expenditure plan, financed mainly by foreign grants and concessionary loans, which should both stimulate the economy and rehabilitate infrastructure. Nevertheless, the recovery is fragile and depends on exogenous factors such as favorable weather, the price of Madagascar's traditional export crops, continued foreign aid flows and debt rescheduling, and a strong world economy, as well as on the government's commitment to reform.

Trade Policy

Madagascar has made significant strides in liberalizing the import regime. The government has eliminated most quantitative restrictions on imports and is rationalizing the tariff system. Foreign exchange is allocated virtually automatically for imports. The Malagasy Central Bank sets the exchange rate at a level designed to equilibrate the supply and demand for foreign exchange. Exchange controls remain on other transactions such as dividend repatriation, although the new investment code, once it is implemented, will remove those restrictions for dividends. The Malagasy franc has been fairly steady against the dollar since 1988. The exchange rate was FMG 1521 per $1 at the end of 1988, FMG 1540 per $1 at the end of 1989, and FMG 1519 per $1 on June 30, 1990. The liberalized import system has resulted in a significant increase in the availablility of consumer goods and has made it much easier for industry to import capital goods, replacement parts and raw materials.

Foreign Investment

While interest in Madagascar on the part of foreign investors has increased in recent years, relatively little foreign investment has actually taken place. Investors have been deterred by the poor investment climate, especially difficulties in obtaining foreign exchange for dividend repatriation. However, the national assembly passed a new investment code and export processing law in December which address many of the problems that had deterred investors.

The new investment code envisions the establishment of an essentially automatic mechanism for providing foreign exchange for dividend repatriation, and the export processing zone law permits investors to maintain foreign exchange denominated

accounts in local banks, over which they will have complete control. If the government follows through on the implementation of these new laws, it will represent a considerable improvement in the investment climate. Six companies -- all in the clothing sector -- have already been approved under the export processing zone law.

Agriculture

The elimination of rice subsidies, price controls, and regional distribution monopolies has succeeded in increasing producer prices over the last few years. The increased efficiency in rice marketing is evidenced by the decline in the margin between producer and consumer prices. Rice production was 11 percent higher in 1989 than 1988, although the increase was probably due as much to better weather as to policy changes. The government hopes that further increases in production will allow Madagascar to reach self-sufficiency in rice in 1991.

The liberalization of the export trade in coffee has resulted in higher producer prices, despite lower world prices. However, the long-run prospects for traditional export products is not encouraging. Madagascar's robusta variety coffee continues to fare badly in international markets, especially following last July's suspension of the economic provisions of the International Coffee Agreement. Indonesia, which is Madagascar's pricipal market for cloves, is steadily increasing its own clove production and importing correspondingly less. The international vanilla market is threatened by synthetic vanilla and increased competition from other natural vanilla producers.

Tourism

Madagascar's tourist industry has grown in the last several years as the government has switched from virtual opposition to tourism to active encouragement of it. The number of tourists visiting the island has increased from 28,000 in 1987 to 39,000 in 1989, and it is expected to reach 60,000 by 1993. The growth of the sector is constrained primarily by a lack of hotels and airline service. There are several hotel projects in the works which should alleviate the first problem, and the government envisions additional air service -- including direct service with South Africa -- to deal with the second constraint.

Parastatal Sector

The nationalization of foreign holdings in the mid-1970s and the "all out investment program" from 1978 to 1981 left Madagascar with an immense parastatal sector. Some of the parastatals are reasonably well run and profitable, while others are mismanaged white elephants. The government has embarked on a program to privatize, liquidate, or rehabilitate many of the parastatals, although progress to date has been limited.

Banking

The Banque Malgache de l'Ocean Indien (BMOI) opened for business in 1989. The new bank has provided a healthy dose of competition to the previously weak banking sector consisting of three state-owned banks: the BNI, BTM, and BFV. The government plans to privatize the state banks, which would further stimulate the sector.

Industry

Malagasy industry has generally been oriented to import substitution, but it is now undergoing a significant restructuring brought about by changes in the foreign trade regime. Some companies are in serious difficulty due to the increased competition from imports, while others are exploiting the export opportunities opened up by the devaluation. Industrial efficiency has also been enhanced by the quicker and better allocation of foreign exchange for imported inputs.

Mining and Petroleum

The country is moderately rich in several minerals, including chromite, graphite, and titanium. Chromite and graphite are currently mined and exported, and a Canadian company is developing a $260 million ilmenite (titanium) mine on the southeast coast. The 600,000 MT per year mine, currently in the design phase, could bring in some $50 million per year in export revenues. The U.S. Trade Development Program has recently approved a $500,000 grant for a feasibility study of a ferrochrome project.

The Environment

Ecologically fragile and unique, Madagascar has in recent years undergone a degree of environmental degradation that has been described as "national suicide." Uncontrolled brush fires, unrestained slash and burn cultivation, the heavy demand for firewood, and catastrophic erosion have already had deleterious effects on Madagascar's agricultural and hydroelectric potential. Recognizing the seriousness of its environmental problems, the government has elicited the help of multilateral and bilateral donors in the elaboration of an Environmental Action Program, which is now being implemented.

IMPLICATIONS FOR THE UNITED STATES

As in previous years, opportunities for U.S. businesses in Madagascar will likely be in projects related to rehabilitation programs funded by multilateral and bilateral assistance programs. Additional business opportunities may develop as a result of Madagascar's aim to privatize certain state-operated enterprises, its newly implemented liberalized import system, and

its plans to create free trade zones. Also, extensive rehabilitation of Madagascar's ports, roads, and railroads should provide attractive business opportunities whenever financing or cofinancing is not tied to a donor country's supplies.

Madagascar is moderately rich in minerals. The Malagasy Government is keenly aware of the large revenue potential in mining its many minerals and is actively pursuing joint ventures with Western investors. Most such activities are under the jurisdiction of the National Military Office for Strategic Industries (OMNIS), an agency directly responsible to the Presidency, which has substantial powers to grant favorable terms to interested investors.

Opportunities for U.S. firms to establish business and professional contacts in Madagascar should be enhanced by future grants from the U.S. Trade and Development Program (TDP). TDP recently approved the final phase of a ferrochrome feasibility study contracted to Guvtavson Associates, Inc., Boulder, Colorado.

The devaluation of the Malagasy Franc has given Madagascar a comparative advantage in many labor-intensive industries such as clothing manufacturing, which presents U.S. companies with opportunities for both direct investment and sales of capital goods.

Another area worthy of interest for U.S. firms is the furnishing of relatively small-scale equipment used in basic economic development activities. Examples would be small sawmills, brick presses, small rock crushers, and the like. The extensive experience of U.S. firms in the mechanization of rural life could be put to very productive use in Madagascar.

Finally, Madagascar's efforts to promote growth in the tourist sector should offer interesting opportunities to U.S. firms in the international hospitality and recreation industries. Madagascar is essentially undeveloped in terms of tourism, and the country's exotic landscapes and wildlife are an enormous potential economic asset. The Malagasy Government's interest in developing its tourism industry is clearly demonstrated by the recent construction of a large hotel resort in Fort Dauphin, a city on Madagascar's southern coast, and contracts to build additional hotel resort areas in other coastal cities.

American companies seeking to do business in Madagascar should keep in mind the importance of employing French-speaking personnel and French-language promotional literature. Even though English is widely understood among members of Madagascar's technical and professional community, firms which do not adapt themselves to Madagascar's French-speaking commercial environment will find themselves at a significant competitive disadvantage.

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